Fiscal Note 2011 Biennium

GOVERNOR'S OFFICE OF
BUDGET AND PROGRAM PLANNING

Bill #	HB0381		**Title:**	Tax credit and deduction for unreimbursed health care expenses
Primary Sponsor:	Miller, Mike		**Status:**	As Introduced

- ☐ Significant Local Gov Impact
- ☐ Needs to be included in HB 2
- ☑ Technical Concerns
- ☐ Included in the Executive Budget
- ☑ Significant Long-Term Impacts
- ☐ Dedicated Revenue Form Attached

FISCAL SUMMARY

	FY 2010 Difference	FY 2011 Difference	FY 2012 Difference	FY 2013 Difference
Expenditures:				
General Fund	$32,144	$50,889	$52,161	$53,465
Revenue:				
General Fund	($66,386,000)	($70,694,000)	($75,364,000)	($80,240,000)
Net Impact-General Fund Balance:	($66,418,144)	($70,744,889)	($75,416,161)	($80,293,465)

Description of fiscal impact: This bill would allow an income tax credit for up to $1,000 of medical expenses, beginning in tax year 2009. Taxpayers who claim the credit would be required to reduce their itemized deductions for medical expenses by the amount of medical expenses used for the credit. This would reduce general fund revenue by $66.4 million in FY 2010, and the revenue reduction would grow by about 6.5% per year.

FISCAL ANALYSIS

Assumptions:

1. Section 1 of this bill would allow an income tax credit of up to $1,000 for medical expenses. The credit would phase out for taxpayers whose gross household income is between 180% and 250% of federal poverty guidelines. Taxpayers would be required to reduce itemized deductions for medical expenses by any amount used to claim the credit (See technical note 2.)
2. Section 2 of this bill would allow taxpayers who take the standard deduction to take an additional deduction for medical expenses greater than 7.5% of adjusted gross income as long as those expenses are not used to claim the credit in Section 1. In most cases, taking the credit allowed by Section 1 would reduce the taxpayer's tax by more than the deduction allowed by Section 2. The only cases where it would be to the taxpayer's advantage to take this deduction would be where the taxpayer's medical costs minus their credit exceeded 7.5% of adjusted gross income. In these cases, the taxpayer is likely to be

itemizing deductions. Therefore, this section is assumed not to have an additional effect on income tax revenue.

3. Credits were calculated for all full year resident returns for 2007. For taxpayers who took an itemized deduction for medical expenses, the credit was calculated from the total medical expenses reported on the return. Taxpayers who do not find it advantageous to take an itemized deduction for medical expenses generally will have lower medical expenses than those who take the deduction. For taxpayers who did not take an itemized deduction for medical expenses, the credit was calculated assuming medical expenses were 1% of Montana adjusted gross income. If this bill had been in effect in 2007, credits would have been $60.283 million.
4. In the HJR 2 income tax revenue estimate, medical insurance deductions are assumed to grow at 6.5082% per year. This fiscal note assumes that the credits allowed by this bill would grow at the same rate.
5. This bill would require taxpayers who claim the credit and take an itemized deduction for medical expenses to reduce their deduction by the amount of costs used for their credit (See technical note 1.) Medical expense deductions on 2007 returns were reduced by the amount of expenses for each taxpayer's calculated credit and the income tax revenue estimation model was run with these lower deductions.
6. This bill would be effective beginning with tax year 2009. The following table shows credits, the increase in tax liability from lower medical deductions, and the net change in income tax liability for tax years 2009 through 2012:
7.

Changes in Calendar Year Tax Liability ($ million)

Tax Year	Credits		Lower Deductions		Net
2009	($68.384)	+	$1.998	=	($66.386)
2010	($72.835)	+	$2.141	=	($70.694)
2011	($77.575)	+	$2.211	=	($75.364)
2012	($82.624)	+	$2.384	=	($80.240)

8. Credits and deductions affected by this bill would be claimed on tax returns filed after the end of each tax year. The change in revenue would come through larger refunds and smaller payments with returns in the spring after each tax year. The changes in tax liability for tax years 2009 through 2013 would result in equal changes in income tax revenue to the general fund in FY 2010 through FY 2013.
9. Eligibility for the credit in Section 1 of this bill is based on gross household income as defined for the elderly homeowner renter credit. In general, this measure of income requires information not reported on income tax returns. The Department of Revenue would need to develop a new form for taxpayers to claim the credit. The cost to develop a new form would be $2,000 in FY 2010. More than half of taxpayers would be eligible for this credit. Due to the large number of credit claims anticipated and the complexity of the credit, the department would require a 1.00 FTE auditing technician position to process and verify credit claims. This position would be filled in the middle of FY 2010, as the first returns claiming the credit are filed. Personnel costs would be $43,193 per year and operating costs would be $7,696 per year. One time costs to set up a new employee would be $4,900 in FY 2010. Changes to the department's data processing system would require 100 hours of programming and 40 hours of testing. Programming would be done by the software vendor as part of the annual maintenance contract, and testing would be done by department employees. There would be no additional monetary costs, but resources would be taken from other tasks.

	FY 2010 Difference	FY 2011 Difference	FY 2012 Difference	FY 2013 Difference
Fiscal Impact:				
FTE	1.00	1.00	1.00	1.00
Expenditures:				
Personal Services	$21,596	$43,193	$44,273	$45,380
Operating Expenses	$5,648	$7,696	$7,888	$8,086
Equipment	$4,900	$0	$0	$0
TOTAL Expenditures	$32,144	$50,889	$52,161	$53,465
Funding of Expenditures:				
General Fund (01)	$32,144	$50,889	$52,161	$53,465
Revenues:				
General Fund (01)	($66,386,000)	($70,694,000)	($75,364,000)	($80,240,000)
Net Impact to Fund Balance (Revenue minus Funding of Expenditures):				
General Fund (01)	($66,418,144)	($70,744,889)	($75,416,161)	($80,293,465)

Long-Term Impacts:

1. As long as medical costs continue to grow faster than income, the revenue reductions from this bill would continue to grow faster than income tax revenue.

Technical Notes:

1. Subsection 1(2) limits the credit to "$1,000 for a household." The word "household" is not defined in Title 15, Chapter 30. It is defined in 15-30-171, MCA, but only for use in 15-30-171 through 15-30-179, MCA. The bill should provide a definition of household, refer to the definition in 15-30-171, MCA, or provide alternative wording, such as "$1,000 for the taxpayer, spouse if filing a joint return, and dependents for whom an exemption is claimed on the taxpayers return."
2. Montana allows the same itemized deduction for medical expenses in excess of 7.5% of adjusted gross income as federal law and, in addition allows a deduction for medical insurance premiums that would not be included in the federal deduction. This fiscal note assumes that medical expenses used as the basis for the credit are assumed to come first from the portion of medical expenses in excess of 7.5% of adjusted gross income, if any, and then from the portion less than 7.5% of adjusted gross income. Thus, the expenditures used for the credit would reduce the deduction, dollar-for-dollar, until the deduction is zero.
3. Subsection 1(7) prohibits non residents and part-year residents from claiming the credits. This could raise constitutional issues under the equal protection clause. If this provision were to be invalidated, the revenue reduction from this bill would be larger.

Sponsor's Initials	*Date*	*Budget Director's Initials*	*Date*